DE-RISKING INVESTMENT IN INFRASTRUCTURE: THE ROLE OF PUBLIC FINANCIAL SUPPORT

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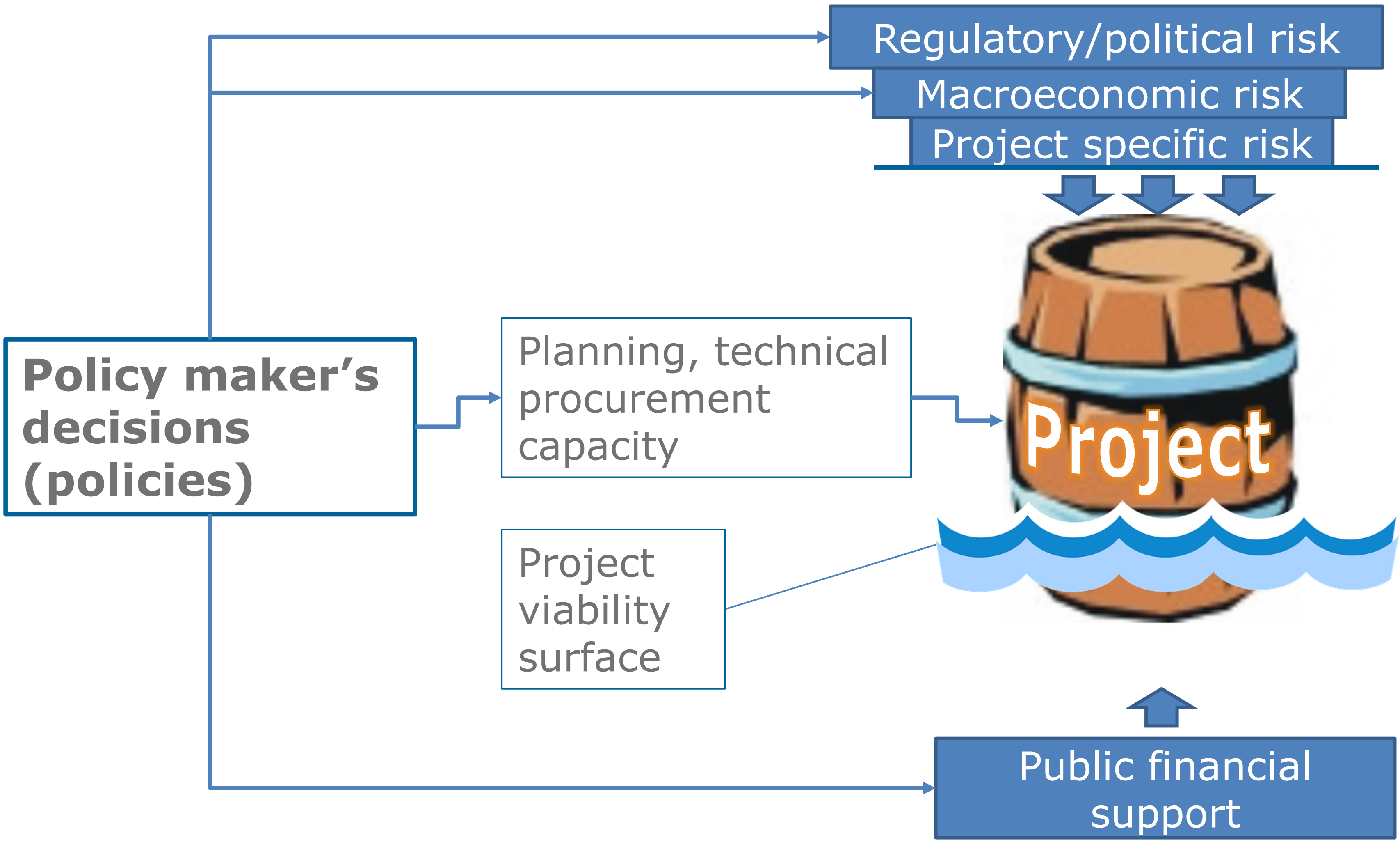
Risk allocation and private investment mobilization are interconnected

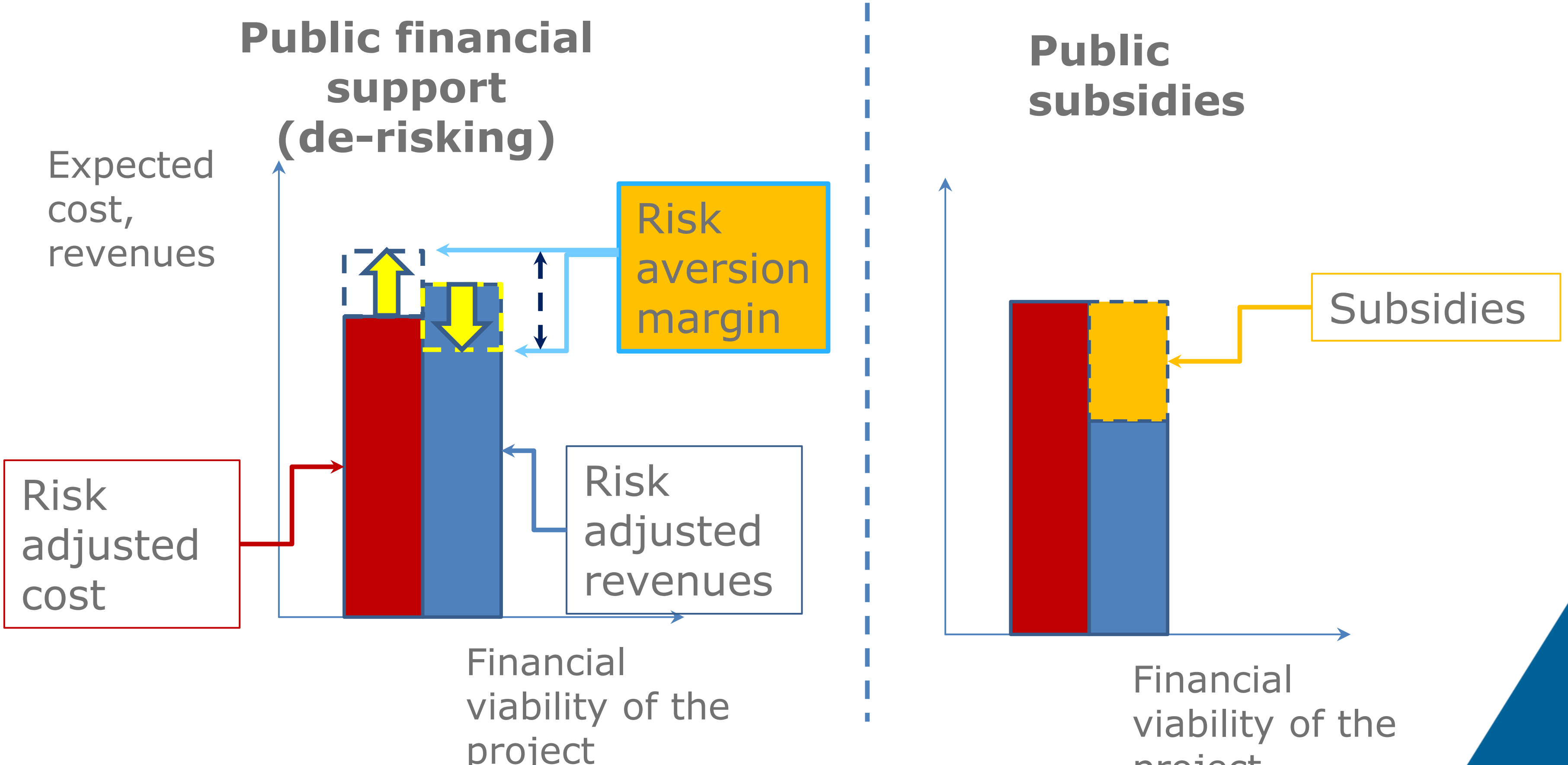
- Governments are pushing for private investment mobilization to counter the drop in public investment and for greater efficiency.
- What are the policies that would make that happen?
- ITF is looking (the upcoming WG) how risk allocation affects outcomes of private participation in infrastructure. Value for Money is the ultimate goal.
- Are these two goals compatible under all macroeconomic conditions?
- The research to be presented next, demonstrates the relevance and complexity of one policy mechanism that affects risk allocation and mobilization of private investment:
  Public financial support to private investment in infrastructure.

How is public support relevant in mobilizing private investment in infra.



Public financial support ≠ subsidies

- Public support to reduce the risk exposure of the private investor has a different context than subsidies.



Public support – its relevance in recent market developments in Europe

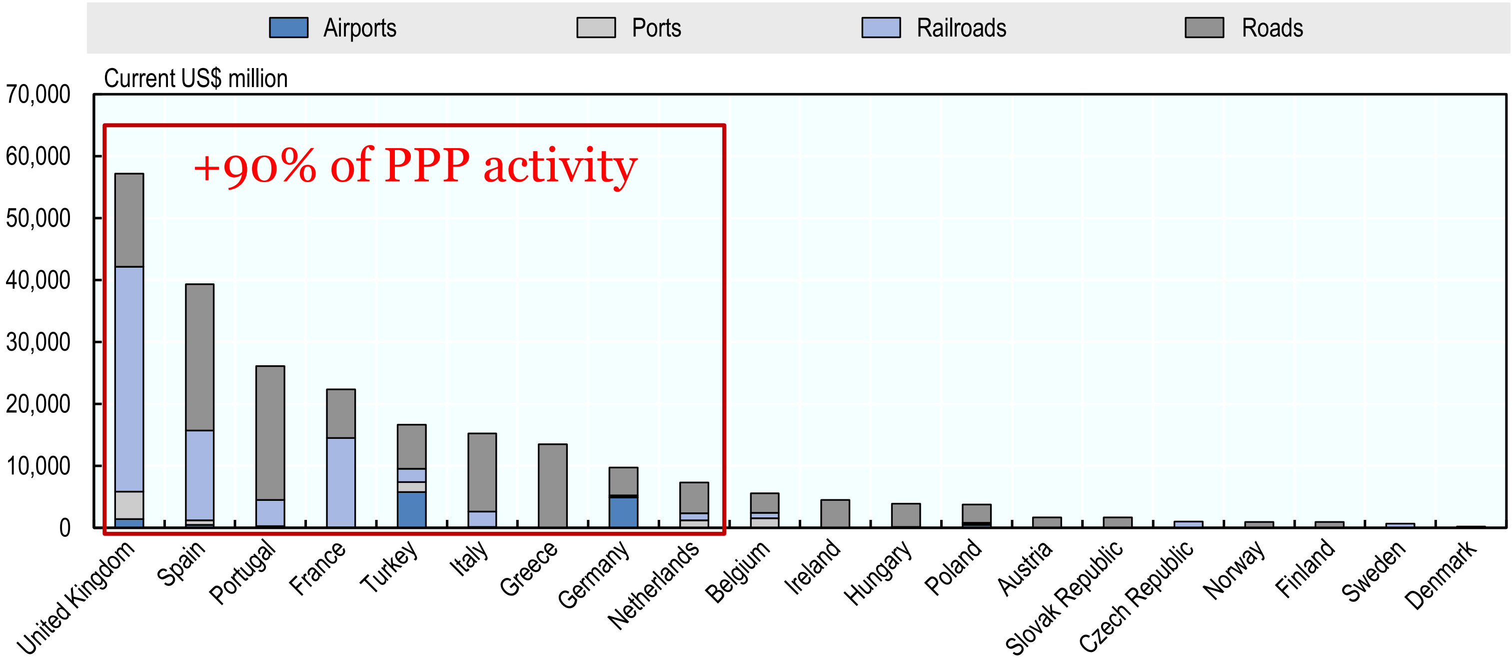
- In mature PPP markets (EU), the initial strongly advocated bottleneck in the mobilization of private investment was the financial crisis which limited the capacity of the capital markets to finance projects.
- In the more recent years financing is no longer considered a defining constraint (banks lending is recovering and new channels of private investment opened as well). Nevertheless, private investment trend is not recovering. Why? What has changed?

H1: There was a change in the need (risk appetite in the market) and a reduction of public financial support.

= Public financial support is a (major) determinant of private investment mobilization in infrastructure.

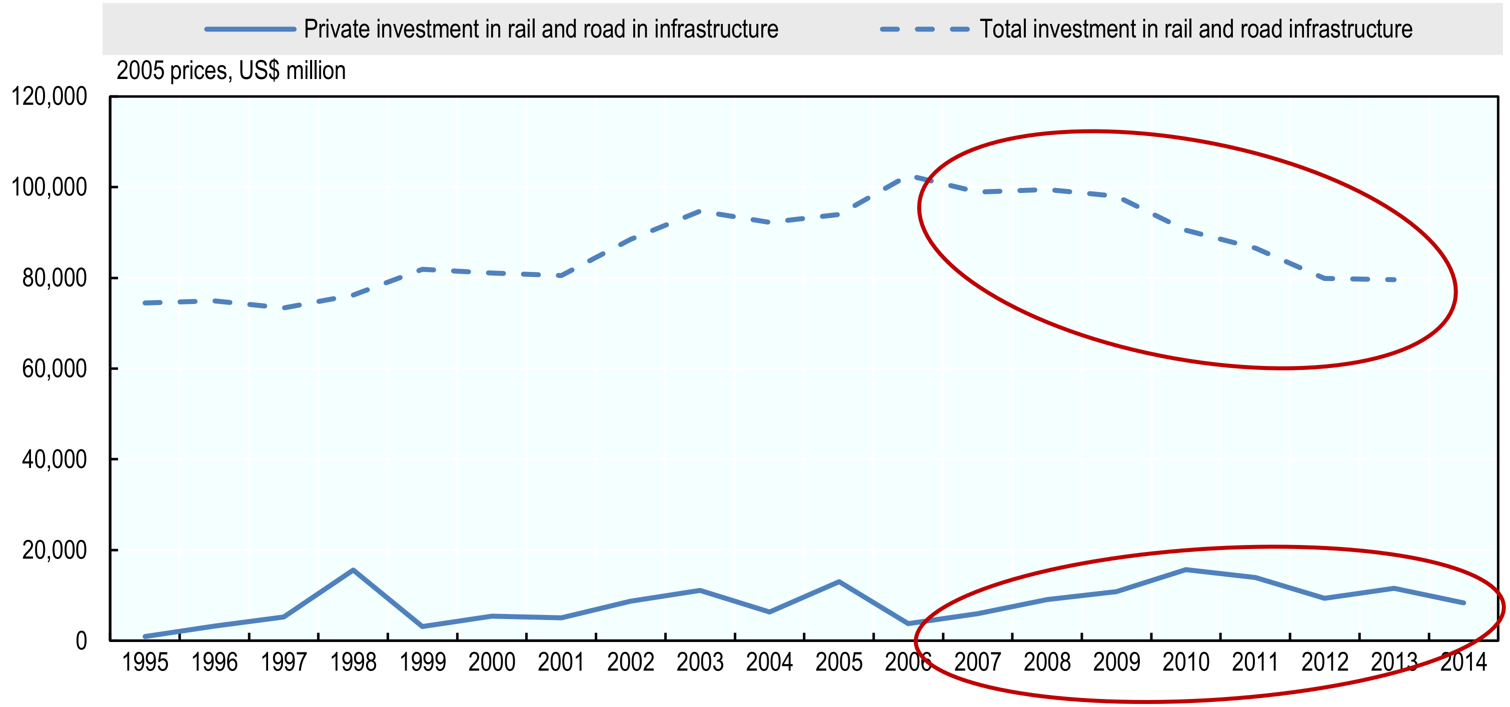
Transport PPPs are concentrated in a few countries

Cumulative Private investment in transport infrastructure per European OECD country and mode, 1995-2014, US$ million



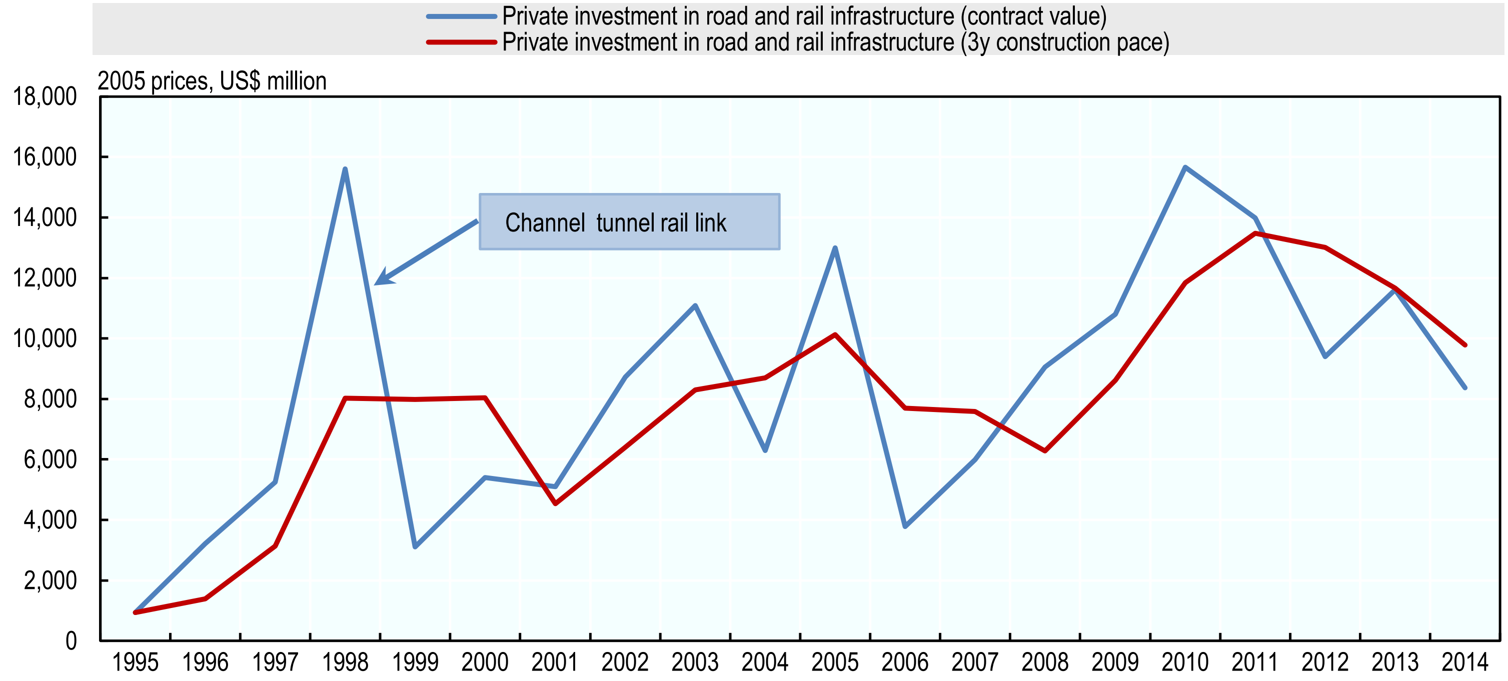
Public investment sustained a much bigger drop than PPPs

Private and total investment in road and rail infrastructure in OECD7* countries, 1995-2014, US$ million, 2005 prices



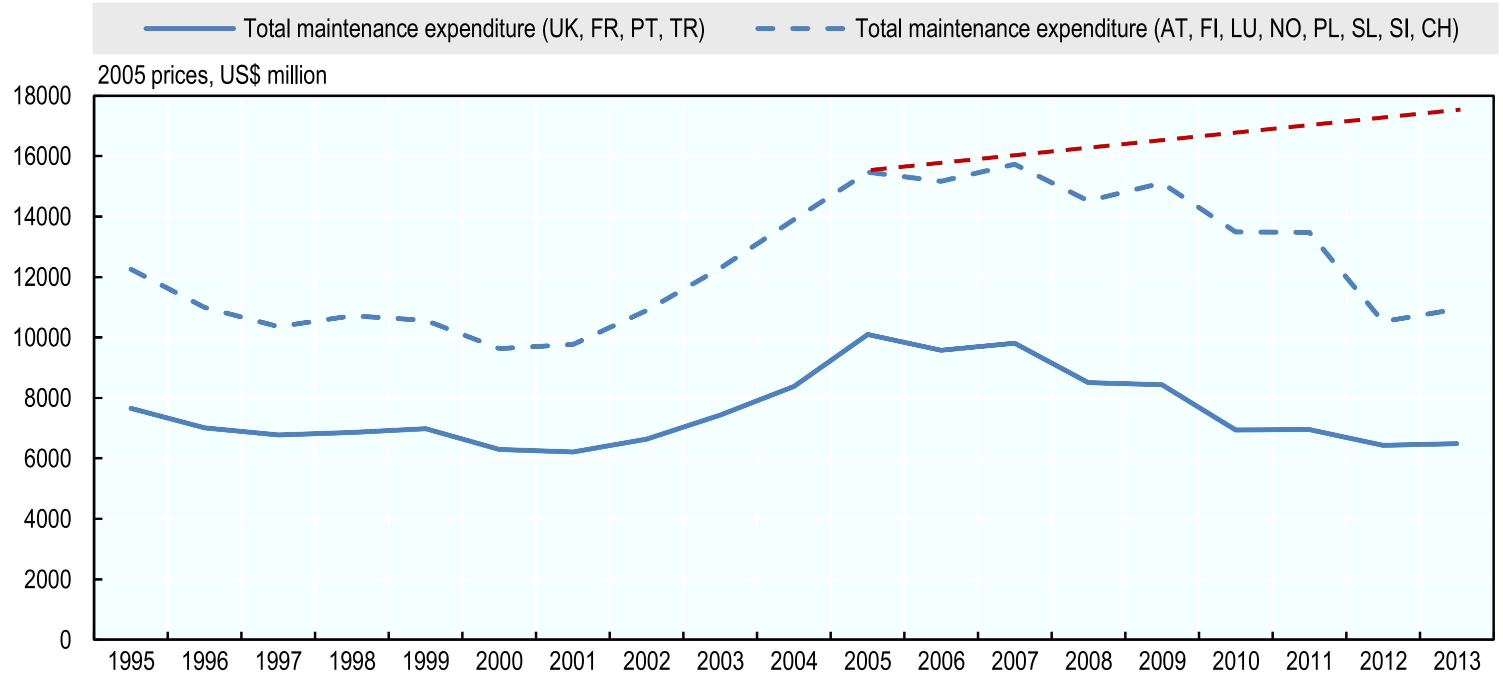
Effectively transport PPPs grew in value until 2010

Private investment in road and rail infrastructure in OECD7 countries, contract value vs. construction pace, 1995-2014, US$ million, 2005 prices



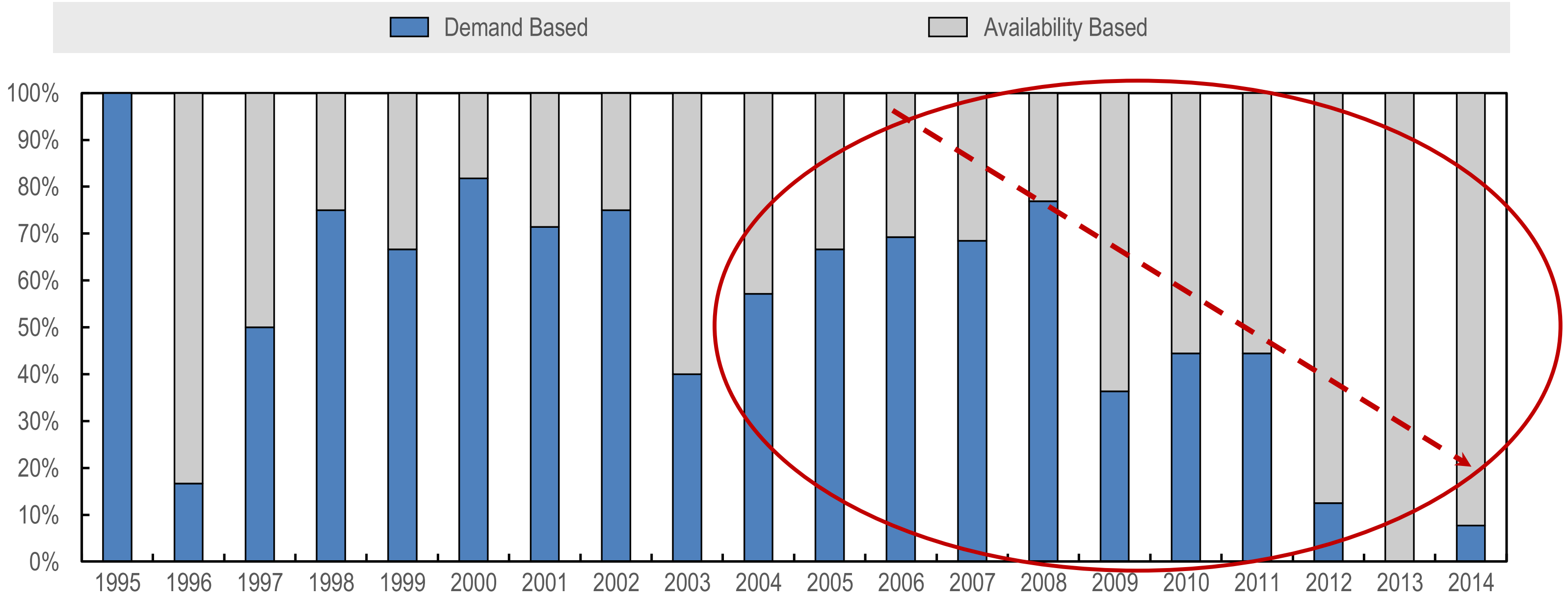
Scarce resources for investment were possibly boosted by reallocations

Road maintenance trends in selected countries, 1995-2014, US$ million, 2005 prices



Risk aversion of investors has increased with the crisis

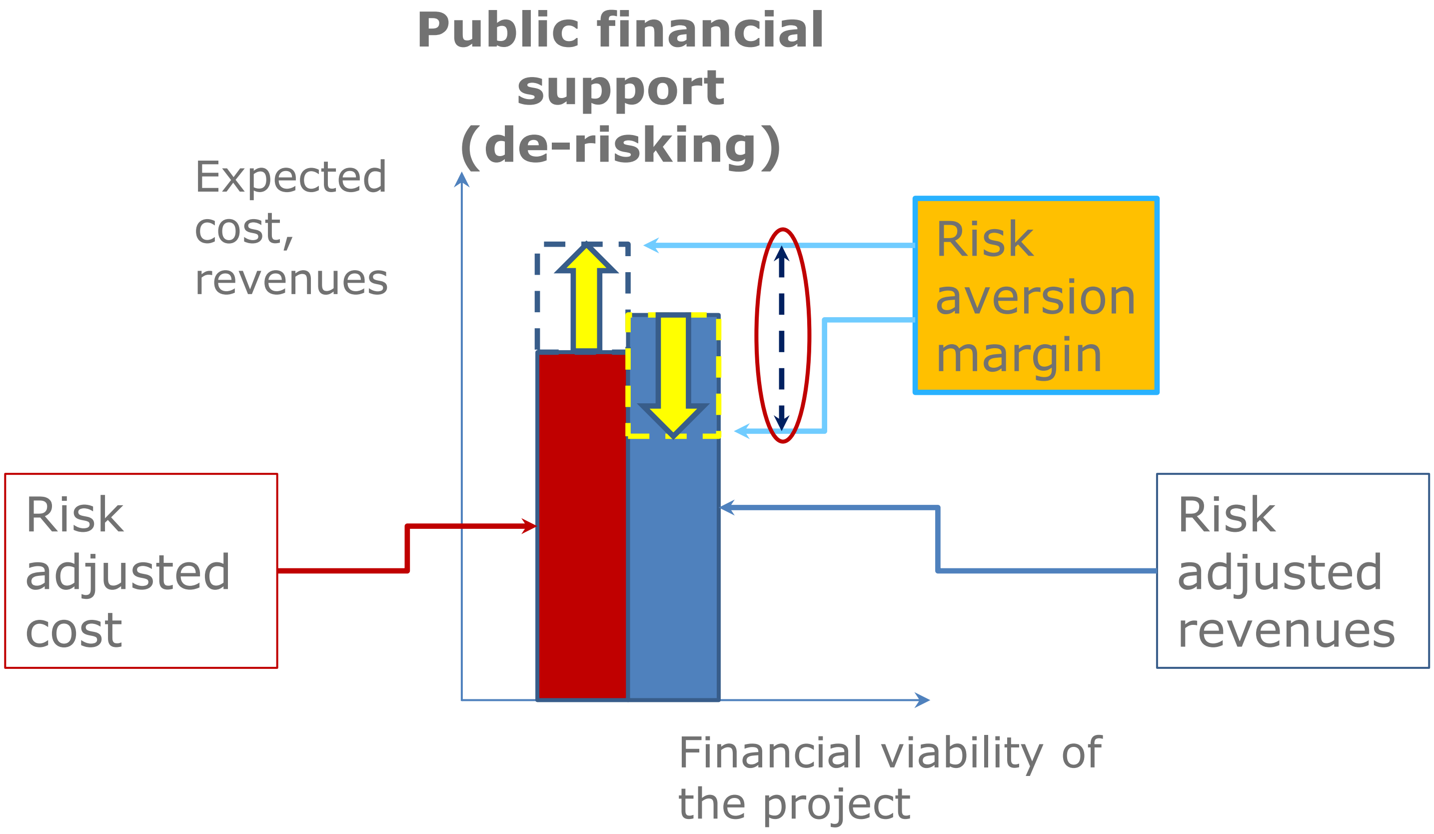
The distribution of demand based vs availability based contracts in private investment in roads, 1995 – 2014, EU.



Defending the hypothesis (I)

Private sector perspective
Political/regulatory risk
X (regulations did not become worse, institutional capacity did not reduce....)
Project specific risk
X (the ground conditions did not become more difficult...)
Macroeconomic
✓ (uncertain future growth, higher risk aversion)

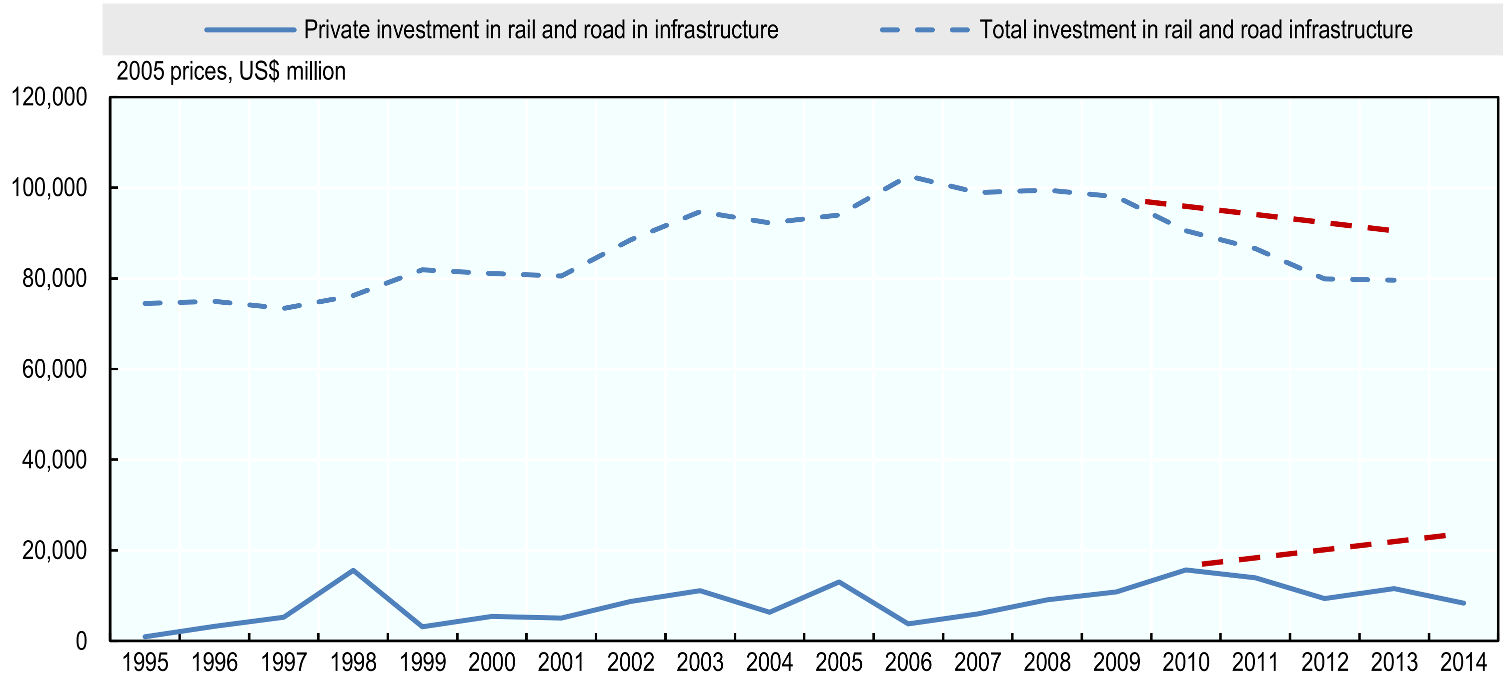
Higher risk aversion requires more public financial support



Defending the hypothesis (II)
Accounting incentives did not work?

Public sector perspective

Scarcity of budgetary resources + ESA rules (off-balance sheet treatment) = Incentive to pursue PPP



Possible explanations, why the accounting motive did not prevail

Public sector perspective

- The accounting treatment motive was **neutralized:**
  - With ESA standard under revision the future accounting treatment of PPPs was not clear to governments (adopted 2014).
  - Due to risk aversion the necessary level of support would have moved projects on the balance sheet even under the old rules.

and/or

- The accounting treatment motive was **offset:**
  - Traditional public investment is deployed faster (structuring a large PPP takes from 18 months to much more in many cases).
  - The cash-flow from traditionally procured/managed projects is easier to control (e.g. temporary reducing maintenance…; to be able to use those funds in other projects). A PPP requires renegotiations…

Policy implications of public financial support

- This policy mechanism is very relevant for mobilizing private investment in infrastructure in general.
- Its relevance increases during adverse macroeconomic conditions due to increased risk aversion.
- But when government budgets are under sufficient strain, governments may not be able or willing to provide sufficient public financial support.
- In addition, with increased risk aversion of private investors, the higher level of necessary public financial support also leads to moral hazard:
  - May reduce Value for Money (efficiency incentives).
  - May induce strategic behaviour of private sector (create excessive expectation for public assistance even when it is not warranted).

Valuable output for ITF's WG

- It is not recommendable to force private investment in infrastructure during an economic crisis (may hurt VfM; the role of the Juncker plan?).

- Implications beyond short-term VfM considerations exist:
  It would be reasonable to maintain some level of private investment in infrastructure also during crisis to keep the private sector alive and preserve the skills, which we will need, when economic recovery is complete.

The optimal risk allocation cannot be considered only in a static vacuum (assuming optimal macroeconomic conditions). The optimum could change, when the (in this case macroeconomic) context changes.

Thank you!

DES POLITIQUES MEILLEURES
POUR UNE VIE MEILLEURE

The Juncker plan, EFSI and the mobilization of transport PPPs